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November 1, 2006

Mr. Larry Jensen, Chief
Office of Audit Services
California Public Employees' Retirement System
Lincoln Plaza North
400 Q Street
Sacramento, CA 95814

Subject:
CalPERS LTC Program -- Margins under Mitigation Strategy

Dear Larry:

At your request, we have performed additional analyses regarding mitigation strategies for eliminating the projected deficit under the CalPERS long-term care program (the Program). Before we describe the results of these analyses, we would like to communicate two points which we believe are critical to the Board of the CalPERS Health Benefits Committee (the Board).

First, any projection of experience under the Program is inexact. Making such a projection involves analyzing, interpreting, extrapolating and modeling very complex Program data to create a foundation on which to build the projection. With that foundation, the analyst must then try to anticipate conditions over very long time horizons such as emerging experience in the old-old population (ages 85+), advances in medical care, increases in life longevity and the resulting impact on the need for LTC services. No one can know these things with any level of certainty. Still, we believe it is essential that Board undertake frequent reviews of the Program's financial status so that it can take corrective action when the need for such action becomes apparent.

Secondly, in light of the uncertainty surrounding this type of a projection, the Board should see our work as essentially in agreement with the work that Mr. Karl Volkmar of United Health Actuarial Services, Inc. (UHAS) has done in projecting liabilities for the Program. Both ours and Mr. Volkmar's results show a significant Program deficit of the same order of magnitude. As you know, we took a completely different approach from the one UHAS used in our work, beginning with Program data at a very elemental level, and we developed our results with no advance knowledge of UHAS's result. It was not until after we provided our result to CalPERS staff that we saw the UHAS results.

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The Board has asked that we collaborate with UHAS to provide a recommendation for a rate increase. To that end, we worked with UHAS to calculate a rate increase that would eliminate the deficit, but would produce no margin, under UHAS's modeling. The rate increase that was calculated is 33.6% and it is our understanding that UHAS's modeling shows this rate increase puts the Program at break-even when combined with the margin generated from 10 years of new business and a 2.5% improvement in claims experience due to improved claims management.

We used the 33.6% rate increase in our model, combined with the 2.5% improvement in claims experience, and 10 years of new business, and arrive at a margin of 5.0% of present value of future premium. Our calculations also assume shock lapses consistent with those that occurred after the rate increase that was implemented in 2003. This assumption is fully consistent with our discussion of mitigation strategies in our October 5, 2006 report titled "Program Review and Long-Term Care Actuarial Valuation at June 30, 2006" that concluded that the 36.6% rate increase being contemplated at the time would produce a 7.9% margin.

We also included in our report a discussion of what we believed to be the most significant differences between our results and those UHAS produced: a difference in claim cost assumptions for policies with and without inflation protection, a difference in the way the IBNR was allocated to incurred age, and differences in assumptions regarding the strength and duration of underwriting selection. At the time we issued our report, we had not had time to reexamine our work in light of UHAS's work. We have reexamined our approach to handling each of these items, and we believe that our approach to each is consistent with sound actuarial principals.

As a final comment, we believe the Board should implement a rate increase that is projected to produce a surplus, and that 5% is within a reasonable range for target surplus.

Please let me know if you have any questions about this work, or if we can be of help to you in any other way. My direct line is 414 223 2280.

Thank you.

Sincerely,



Kurt J. F. Giesa, FSA, MAAA

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